

**STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
45 Fremont Street, 21st Floor
San Francisco, California 94105**

TEXT OF REGULATION

DATE: April 2, 2010

REGULATION FILE REG-2010-00001

Standards and Training for Estimating Replacement Value on Homeowners' Insurance

ADD

New Section 2188.65 to Article 6.5 of Subchapter 1 of Chapter 5 of Title 10 of the California Code of Regulations, as follows.

Adopt Section 2188.65. Broker-agent Training on Estimating Replacement Value.

(a) As used in this section 2188.65 and in Insurance Code section 1749.85 the following terms have the following meanings:

(1) "Homeowners' insurance policy" shall have the same meaning as "policy of residential property insurance" as defined in subdivision (a) of Insurance Code section 10104, except that a policy covering an individually owned mobile home shall also constitute a homeowner's insurance policy.

(2) "Replacement value" shall have the same meaning as "replacement cost" and is defined as the amount it would cost to repair, rebuild or replace a completely damaged or destroyed structure, without a deduction for physical depreciation.

(3) "Fire and casualty broker-agent" and "personal lines broker-agent" mean holders of the licenses defined in Insurance Code sections 1625 and 1625.5, respectively. Fire and casualty broker-agents and personal lines broker-agents are also referred to as "broker-agents" in this section.

(b) On and after the day that is ninety days after the effective date of this section, every California resident fire and casualty broker-agent and personal lines broker-agent must satisfactorily complete one three-hour training course on homeowners' insurance valuation prior to soliciting individual consumers in order to sell dwelling fire or homeowners' insurance. For resident broker-agents, this requirement shall be part of, and not in addition to, the continuing education requirements of Insurance Code section 1749.3.

(c) The training required by this section must be approved by the commissioner and shall consist of topics related to dwelling, fire, and homeowners' insurance. Any course taken to satisfy the requirements stated in Section 1749.85 of Insurance Code shall use subject matter described in this article.

(d) The broker-agent shall be trained on the differences between homeowners' insurance coverage and other Fire, and Dwelling Property policies, which differences may necessitate differences in coverage or coverage levels. The broker-agent shall also be trained on the basic concepts of property insurance and estimating replacement value, which includes:

(1) How loss settlement provisions in an insurance policy apply to major claims and the potential causes and effects that underinsurance may have on settlement;

(2) The differences in the measure of indemnity between actual cash value coverage and replacement cost coverage, as summarized in Insurance Code sections 2051, 2051.5, and 10102, including:

(A) California Residential Property Insurance Disclosure, as described in Insurance Code section 10102; and

(B) Depreciation and how it is applied under a homeowners' insurance policy;

(3) The several components of a structure necessary to estimate replacement cost, as well as all other costs incident to reconstruction, including but not limited to:

(A) Type of foundation;

(B) Type of frame;

(C) Roofing materials and type of roof;

(D) Siding materials and type of siding;

(E) Whether the structure is located on a slope;

(F) Size of the entire structure and, separately, the square footage of the living space;

(G) Geographic location of property;

(H) Number of stories and any nonstandard interior wall heights;

(I) Materials used in, and types of, interior features and finishes;

(J) Cost of demolition and debris removal;

(K) Architect's plans, engineering reports, and permits;

(L) Age of the structure or the year it was built; and

(M) Additional costs associated with building a single or custom home.

(4) The effects of catastrophes on replacement cost. This includes how shortages of construction labor, building supplies, fuel, transportation issues, and permit restrictions can result in increased costs, sometimes referred to as demand surge, and delays in rebuilding.

(5) Review of the significant enhancements and endorsements to the homeowners' insurance policy, and identify of coverages that help protect against underinsurance. The review is to include:

(A) what is included and excluded in Building Code Upgrade (Ordinance and Law) Coverage, as defined in California Insurance Code section 10102; and

(B) the various types and levels of replacement cost, as defined in California Insurance Code section 10102;

(6) Review of the California Standard Form Fire Policy and FAIR Plan coverages, as described in California Insurance Code sections 2071 and 10090, respectively.

(7) Review of the types of basic building construction, including tilt-up, cinderblock, wood frame, brick and masonry, and metal frame.

(8) Review of the various methodologies of estimating replacement cost including:

(A) Proprietary replacement cost valuation tools;

(B) Real estate appraisals;

(C) Insurance company's valuation software;

(D) Contractor's and architect's estimates or opinions;

(E) Cost per square footage estimates; and

(F) Insured's opinion.

(9) Review of fire mitigation and how it affects insurance costs, to include:

(A) Define, recognize, and describe the fire problem in the wildland urban interface;

(B) Discuss the areas that affect the risk and hazard such as topography, fuel types and locations, weather, and construction; and

(C) Discuss current statutes and regulations that address efforts to mitigate and indicate that local codes may also apply. These statutes, regulations and codes include requirements for defensible space and fire-resistant building construction.

(e) The training required by this section 2188.65 shall ensure that the broker-agent is aware of the provisions of sections 2695.182 and 2695.183.

(f) Any course or seminar that is disapproved for the reason that it fails to comply with this section shall be presumed invalid for credit towards the continuing education requirement of this section unless the course or seminar is later approved in writing by the commissioner.

NOTE: Authority cited: Sections 790.04, 790.10, 1749.7, 1749.85, and 2051.5, Insurance Code.

Reference: Sections 790.03, 790.04, 1625, 1625.5, 1749.1, 1749.3, 1749.31, 1749.85, 2051.5, and 10087, Insurance Code.

AMEND

Section 2190.2 of Article 7 of Subchapter 1 of Chapter 5 of Title 10 of the California Code of Regulations, as follows.

Section 2190.2. Required Records.

Wherever applicable, the following records shall be maintained by every agent or broker or surplus lines broker or special lines surplus lines broker with respect to each and every insurance transaction for at least five years after expiration or cancellation date of the policy to which the records pertain:

- (a) Name of insured,
- (b) Name of insurer,
- (c) Policy number,
- (d) Effective date, termination date and mid-term cancellation date of coverage,
- (e) Amount of gross premium,
- (f) Amount of net premium,
- (g) Amount of commission and basis on which computed,
- (h) Names of persons who receive, or are promised, any commissions or other valuable consideration related to the transaction,
- (i) Amount of premium received including itemization of any partial payments or additional premium,
- (j) Date premium received by agent or broker,
- (k) Date deposited in bank account or bank depository into which premiums are deposited or maintained in accord with Section 1733 of the Insurance Code, including but not limited to trustee accounts maintained pursuant to Section 1734 of the Insurance Code,
- (l) Name and address of bank and number of account in which premium is deposited or maintained in accord with Section 1733 of the Insurance Code, including but not limited to trustee accounts maintained pursuant to Section 1734 of the Insurance Code,
- (m) Date premium paid by agent or broker to the person entitled thereto and identification of the means of transmittal,
- (n) Amount of net and gross return premium,
- (o) Date return premium is received from insurer by agent or broker which may be the date the credit is taken from the insurer or the date the check or draft is received, ~~and~~
- (p) Date gross return premium is remitted to person entitled thereto by agent or broker and identification of means of transmittal, ~~and~~
- (q) Any documents required to be maintained pursuant to Section 2695.182, except that documents to which the last sentence of Section 2695.182 applies must be maintained for the three-year period specified in that sentence.

NOTE: Authority cited: Sections 1727, 1763 and 1768, Insurance Code. Reference: Sections 1760.5(b), 1763 and 1764.1, Insurance Code.

AMEND

Section 2190.3 of Article 7 of Subchapter 1 of Chapter 5 of Title 10 of the California Code of Regulations, as follows.

Section 2190.3. Records by File.

(a) Wherever applicable, the following records shall be maintained by every agent or broker and surplus lines broker and special lines' surplus lines broker in a file pertaining to a particular insured for a period of eighteen months after the transaction described by such records:

(1) Identity of each person who transacted the insurance, renewals and any change in coverage,

(2) Records of all binders, whether written or oral, showing the names of insured and insurer, nature of coverage, effective and termination dates and premium for binder or policy to be issued,

(3) Copy of application or memorandum of request for insurance,

(4) Correspondence received, copies of correspondence sent, memoranda, notes of conversation, or any other record necessary to describe the transaction.

(b) The following records of surplus line transactions shall be maintained by every agent and broker and surplus lines broker and special lines' surplus lines broker for a period of at least five years after expiration or cancellation date of the policy to which the records pertain: forms, reports or statements required to be maintained or filed under Sections 1763 and 1764.1 of the Insurance Code.

(c) The agent, broker, surplus line broker or special lines' surplus lines broker who signs the form, report or statement under Insurance Code Section 1763 shall maintain the original. The agent, broker, surplus lines broker or special lines' surplus lines broker who receives the originally signed disclosure statement under Insurance Code Section 1764.1 shall maintain the original.

(d) The agent, broker, surplus line broker or special lines' surplus lines broker who signs the diligent search form under Insurance Code Section 1763 or receives the originally signed disclosure statement under Insurance Code Section 1764.1 shall send copies to all other agents, brokers, surplus lines brokers or special lines' surplus lines brokers involved in the transaction.

(e) The agent, broker, surplus line broker or special lines' surplus lines broker who receives copies of documents pursuant to 2190.3(d), shall maintain the copies which show the signature of the agent, broker, surplus lines broker, special lines' surplus lines broker or applicant who signed it.

(f) An agent or broker who provides an estimate of replacement cost or any estimate of construction costs to an applicant or insured with respect to a policy of homeowner's insurance shall maintain records as mandated by Section 2695.182.

NOTE: Authority cited: Sections 1727, 1763 and 1768, Insurance Code. Reference: Sections 1760.5(b), 1763 and 1764.1, Insurance Code.

ADD

New Article 1.3: Valuation of Homes to Subchapter 7.5 of Chapter 5 of Title 10 of the Insurance Code, as follows.

Article 1.3. Valuation of Homes.

Adopt Section 2695.180. Definitions.

As used in this article and in California Insurance Code section 1749.85 the following terms have the following meanings:

(a) "Homeowners' insurance policy" shall have the same meaning as a "policy of residential property insurance" as defined in subdivision (a) of Insurance Code section 10104, except that in this article a policy covering an individually owned mobile home shall also constitute a homeowner's insurance policy.

(b) "Replacement value" shall have the same meaning as "replacement cost" and is defined as the amount it would cost to repair, rebuild or replace a completely damaged or destroyed structure.

(c) "Fire and casualty broker-agent" and "personal lines broker-agent" mean holders of the licenses defined in Insurance Code sections 1625 and 1625.5, respectively. Fire and casualty broker-agents and personal lines broker-agents are also referred to as "broker-agent" in this article.

(d) "Licensee" means

(1) any person or entity that holds a license or certificate of authority issued by the Department of Insurance;

(2) a broker-agent; or

(3) any other entity for whom the Insurance Commissioner's consent is required before transacting business in the State of California or with California residents.

NOTE: Authority cited: Sections 790.10, 1749.7, 1749.85, and 2051.5 of the California Insurance Code. Reference: Sections 790.03, 1625, 1625.5, 1749.85, 2051.5, and 10104 of the California Insurance Code.

Adopt Section 2695.181. Standards for Real Estate Appraisers.

Subdivision (d) of Insurance Code 1749.85 provides that if the Department of Insurance, by adopting a regulation, establishes standards for the calculation of estimates of replacement value of a structure by appraisers, then on and after the effective date of the regulation a real estate appraiser's estimate of replacement cost shall be calculated in accordance with the regulation. A real estate appraiser, whether or not a licensee, shall not estimate the replacement cost of a structure for use in connection with a homeowner's insurance policy unless the estimate of replacement cost complies with the provisions of subdivisions (a) through (e) of

Section 2695.183. Appropriate licensure by the Department of Insurance is required in order to lawfully explain levels of coverage under a homeowners' insurance policy.

NOTE: Authority cited: Sections 35, 1631, 1633, 1749.7, 1749.85, and 2051.5, Insurance Code. Reference: Sections 35, 1631, 1633, 1625, 1625.5, 1749.85, 2051.5, and 10087, Insurance Code.

Adopt Section 2695.182. Documentation of Person Making Estimate.

(a) In the event an estimate of replacement cost or any estimate of construction costs is provided by a licensee to an applicant or insured, the licensee shall document and maintain in the applicant's or insured's file the following information:

(1) The status of the person providing the estimate, as the insurer underwriter or actuary or other person identified by the insurer, a broker-agent, a contractor, an architect, a real estate appraiser, or other person or entity permitted to make such an estimate by Insurance Code section 1749.85;

(2) The name, job title, address, telephone number, and license number, if applicable, of the person providing the estimate of replacement value or construction costs;

(3) The source from which or method by which replacement value or construction cost was determined, to include any replacement cost calculator, contractor's estimate, architectural report, real estate appraisal, or other source or method; and

(4) A copy of any reports, inspection reports, contractor's estimates, or other documents used to estimate replacement value or construction costs.

(b) In the event the estimate of replacement cost or of construction costs is provided by a licensee to an insured, the licensee shall maintain in the insured's file the records specified in subdivision (a) of this Section 2695.182 for the entire term of the insurance policy or the duration of coverage, whichever terminates later in time, and for five years thereafter. In the event the estimate of replacement cost or of construction costs is provided by a licensee to an applicant to whom an insurance policy is never issued, the licensee shall maintain in the applicant's file the records specified in subdivision (a) of this Section 2695.182 for a period of three years following the time the estimate is generated.

NOTE: Authority cited: Sections 730, 790.04, 790.10, 1727, 1749.7, and 1749.85, Insurance Code. Reference: Sections 730, 790.03, 790.04, and 1749.85, Insurance Code.

Adopt Section 2695.183. Standards for Replacement Cost Estimates and Other Construction Cost Estimates.

No licensee shall estimate replacement cost, or shall rely on an estimate of replacement cost, to set or recommend a policy limit on a homeowners' insurance policy for an applicant or insured, or to provide to the applicant or insured for his or her consideration, unless the requirements and standards set forth in subdivisions (a) through (e) below are met:

(a) The estimate of replacement cost shall include all expenses that would reasonably be incurred to rebuild the insured structure(s) in its entirety, including but not limited to:

(1) Cost of labor, building materials and supplies;

(2) Overhead and profit; and

(3) All components and features of the insured structure, as well as all other costs incident to reconstruction, including, but not limited to:

(A) Type of foundation;

(B) Type of frame;

(C) Roofing materials and type of roof;

(D) Siding materials and type of siding;

(E) Whether the structure is located on a slope;

(F) Size of the entire structure and, separately, the square footage of the living space;

(G) Geographic location of property;

- (H) Number of stories and any nonstandard wall heights;
 - (I) Materials used in, and types of, interior features and finishes;
 - (J) Cost of demolition and debris removal;
 - (K) Architect's plans, engineering reports and permits, as well any other plans and reports reasonably necessary to effectuate a complete rebuilding of the structure; and
 - (L) Age of the structure or the year it was built.
- (b) The estimate of replacement cost shall be based on an estimate of the cost to rebuild or replace the structure taking into account the cost to reconstruct the single property being evaluated, as compared to the cost to build multiple, or tract, properties.
- (c) The estimate of replacement cost shall not be based upon the resale value of the land, or upon the amount or outstanding balance of any loan.
- (d) The estimate of replacement cost shall not include a deduction for physical depreciation.
- (e) A licensee that estimates replacement cost, or that relies upon an estimate of replacement cost produced by another, to set or recommend a policy limit on a homeowners' insurance policy for an applicant or insured, or to provide to an applicant or insured for his or her consideration, shall take reasonable steps to verify that the sources and methods used to estimate replacement cost are kept current to reflect changes in the costs of reconstruction and rebuilding, including changes in labor, building materials, and supplies, based upon the geographic location of the insured structure. The estimate of replacement cost shall be created using such current sources and methods.
- (f) For purposes of this subdivision (f) "demand surge" is a phenomenon characterized by a substantial increase in the cost of construction due to unusually high demand for contractors, building supplies and construction labor. Demand surge typically occurs after a disaster, such as a wildfire, earthquake, or other natural disaster, in which large numbers of structures are destroyed within a specific geographic area. A replacement cost estimate or construction cost estimate generated by or on behalf of a licensee in connection with a homeowner's insurance policy shall not include consideration for demand surge. The licensee shall disclose to the applicant or insured in the notice or report required under subdivision (h) of this Section 2695.183 the fact that the demand surge has not been, and cannot legally be, taken into account in formulating the estimate. However, nothing in this article shall be interpreted to forbid a licensee from making known to an applicant or insured any coverage options that may be available for obtaining insurance to protect against the contingency of demand surge.
- (g) The provisions of this article are binding upon licensees, notwithstanding the fact that information, data or statistical methods used or relied upon by a licensee to estimate replacement cost may be obtained through a third party source. Any and all information received by the Department pursuant to this article shall be accorded the degree of confidential treatment required by section 735.5 of the Insurance Code or Chapter 2 of Part 1 of Division 3 of Title 2 of the Government Code, commencing at section 11180.
- (h) If a licensee uses an estimate of replacement cost or construction costs to set, recommend or communicate about a policy limit on a homeowners' insurance policy for an applicant or insured, the licensee must provide a copy of the replacement cost estimate or construction cost estimate to the applicant or insured at the time the policy limit is set, recommended or is otherwise the subject of communication by the licensee. If the estimate of replacement cost or construction costs is updated or changed by, or on behalf of, the licensee, the licensee shall provide a copy of the revised estimate of replacement cost to the applicant or insured within sixty (60) calendar

days from the time the estimate is generated. The estimate of replacement cost or construction costs must itemize each element specified in subdivision (a) of this Section 2695.183.

(i) Licensees shall maintain (1) a record of the information supplied by the applicant or insured that is used by the licensee to generate the replacement cost estimate or any construction cost estimate and (2) a copy of any replacement cost estimate and any construction cost estimate supplied to the applicant or insured pursuant to subdivision (i) of this Section 2695.183. If a policy is issued, these records and copies shall be maintained in the insured's file for the entire term of the insurance policy or the duration of coverage, whichever terminates later in time, and for five years thereafter. However, in the event the estimate is provided to an applicant to whom an insurance policy is never issued, the records and copies referred to in the first sentence of this subdivision (i) shall be maintained in the applicant's file for a period of three years following the time the estimate is generated.

(j) When setting, recommending or communicating about a policy limit on a homeowners' insurance policy, to characterize using any form of the word "replace" or "replacement" any estimate of construction costs not comporting with subdivisions (a) through (e) of this Section 2695.183 constitutes making a statement with respect to the business of insurance which is misleading and which by the exercise of reasonable care should be known to be misleading, pursuant to Insurance Code section 790.03. Notwithstanding the preceding sentence, a licensee that provides an applicant or insured with any estimate of construction costs that does not satisfy all of the requirements of subdivisions (a) through (e) of this Section 2695.183 shall indicate that it is not an estimate of replacement cost and shall identify and explain in the estimate each of the ways in which the estimate of construction costs that is provided fails to meet the requirements for a replacement cost estimate that are stated in said subdivisions (a) through (e).

(k) When an insurer requires that a broker-agent utilize a specific source or tool to create an estimate of replacement cost or construction costs,

(1) the insurer shall prescribe procedures to be followed by broker-agents when they use the source or tool,

(2) the insurer shall provide the broker-agent with the training or training materials necessary to properly utilize the source or tool according to the insurer's prescribed procedures, and

(3) the insurer, and not the broker-agent, shall be responsible for any noncompliance with the provisions subdivisions (a) through (f) of this Section 2695.183, unless that noncompliance results from failure by the broker-agent to follow the insurer's prescribed procedures when using the source or tool.

(l) This Section 2695.183 applies to all communications by a licensee, verbal or written, with the sole exception of internal communications within an insurer, or confidential communications between an insurer and its contractor, that concern the insurer's underwriting decisions and that never come to the attention of an applicant or insured.

(m) No provision of this article shall be construed as requiring a licensee to estimate replacement cost to set, or recommend to an applicant or insured, a policy limit on a homeowners' insurance policy. No provision of this article shall be construed as requiring a licensee to advise the applicant or insured as to the sufficiency of such an estimate.

NOTE: Authority cited: Sections 730, 790.03, 790.04, 790.10, 1749.7, 1749.85, 1861.05, and 2051.5, Insurance Code. Reference: Sections 730, 790.03, 790.04, 735.5 and 1749.85, Insurance Code.